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Address by the Comptroller General of the United States,
Elmer B. Staats, to the Joint State-Federal Financial Manage-
ment Conference, Washington, D.C., October 9, 1970

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[PROGRESS IN THE FINANCIAL MANAGEMENT OF
FEDERAL GRANT-IN-AID PROGRAMS]

I appreciate the opportunity to take part in this first Federal/State conference on financial management in the intergovernmental relations area. I hope that the conference will be helpful in fostering improved communication between the different levels of Government and, hopefully, in bringing forth some ideas on where and how we can make better progress in improving grant-in-aid programs.

It would be hard to find an area of government activity today with problems of financial management more pressing or more difficult than in the area of Federal grants-in-aid. From rather modest beginnings, this means of assisting the financing of services provided by State and local governments has today reached gigantic proportions.

Federal grants to State and local governments came into being more than a century ago. Under the Morrill Act of 1862, States received Federal lands to establish "land-grant" colleges offering courses in agriculture, engineering, and home economics. These grants were subject to conditions spelled out in the law and to Federal supervision.

In the early 1900's, Federal aid was extended through other programs. The 1930's gave birth to a large number of Federal welfare, employment security, housing, and health programs. The ensuing years brought forth many new and expanded programs in all of these areas.

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In recent years, the Federal Government has undertaken through grants to help broaden elementary, secondary, and higher education opportunities; to develop economically depressed areas; to finance improved health services and medical care for the indigent; to attack poverty; to improve environmental quality; and to transform city areas encumbered by slums into desirable neighborhoods.

Recent growth of Federal grants-in-aid has been great and can be expected to continue. It is now running at about 27 billion dollars.

Estimates of the number of Federal-aid programs differ, depending on which criteria are used. The figure most frequently cited is 400; other estimates put the number at around 1300. These programs are administered by 21 Federal agencies through 150 major Washington bureaus and over 400 field offices.

The growth in Federal grants-in-aid, and in governmental services and activities in general, is the result of our political decision-making process acting in response to problems brought on by technological, economic, and sociological changes in our society. Increases in population, shifts in population from rural to urban areas and from center city to suburbia, and changes in necessary job skills and educational levels stemming from technological development and increasing demands for services, have all had their effect.

The resultant seemingly endless number and variety of programs have so proliferated and have such diverse features and requirements that State and local governments are faced with a multiplicity of administrative, financial, and reporting problems.

The brunt of the demand for increased governmental services has fallen on State and local governments which traditionally have administered to the needs of the people. The Federal Government has been drawn into the picture because of its better command of financial resources and its concern for the general welfare of the residents of all States, and because certain problems transcend the jurisdiction of State and local governments. Also, recognition of differing State fiscal capacities and the need to establish minimum standards tending to equalize services to all citizens have increased Federal involvement in these problems.

With few exceptions, direct administration of Federal grant programs is by non-Federal managers and, on an overall basis, almost four-fifths of their cost comes from non-Federal sources. The Federal Government is assisting the States to fund programs which they are conducting to serve their constituencies, and to help achieve national goals.

However, there is a price which goes with acceptance of the funds, whether supplied from State or Federal sources, and that is the responsibility for the proper management of the resources so entrusted. Such management requires a large measure of sophistication in management techniques. It entails such internal controls as proper organizational structure, checks and balances in transaction operations, and internal audit. It requires adequate and proper information systems, integrated with the organization's accounting records when advantageous to do so. It requires operational standards, responsibility accounting, and the use of cost-benefit methods in planning and evaluating alternative ways to carry out the programs. Most importantly, it requires that the managers

be informed--that is, be informed of program plans, standards, and operations. To be adequately informed they must have valid financial and operating reports and they must be apprised as to the efficiency and effectiveness of operations.

Because GAO has a relatively small staff in contrast to the great number, diversity and wide geographical distribution of the Federal grant programs, we could not possibly review in detail the total funds expended under such programs. Our emphasis has been directed toward improving, with respect to individual programs, the adequacy and reliability of the management systems utilized by the Federal, State, and local governments. These systems provide the vehicle for an appropriate discharge of responsibility by all parties concerned.

In view of the increasing number of grant-in-aid programs, the resultant difficult problems of administration, and our desire and need to move toward broader areas of inquiry, we believe we must go beyond the individual programs and consider problems and opportunities for improvement from a broader viewpoint. We must view the responsibilities of State and local governments in the grant-in-aid area from the perspective of the overall part they play in financial management with respect to a large portion of the Federal budget.

As I mentioned, Federal grant-in-aid programs serve many different objectives such as education, housing, job training and employment, health, and income maintenance. Each of these objectives is served by several different programs, often administered by different Federal agencies in cooperation with different units of State government and, either directly or through the State, different units of local government.

These factors operate to make difficult and to place constraints on the improvement of financial management. They also make necessary, as a condition precedent to dramatic improvement, a great deal of effort in identifying and defining specific problems and their relationship to the broader picture, in order to permit the development of solutions which give consideration to the "real world."

Indeed, the task confronting us all is immense and it will require that all parties bring to bear upon these problems the utmost in research and innovative resources. Some beginnings have been made but we all have a long way to go.

Specific and serious inquiries into the problems of financial administration of grants started in 1962 when the Muskie Subcommittee was authorized "to examine, investigate, and make a complete study of inter-governmental relationships between the United States and the States and municipalities." The purpose of this study was to assist in strengthening the Federal system and to enhance cooperation among all levels of government. This study, which was made through a questionnaire and an analysis of responses, resulted in three very informative reports. The Muskie Subcommittee has continued its deep interest in this area.

The Advisory Council on Intergovernmental Relations has also actively considered many of the problems of grant-in-aid administration and has made numerous recommendations in several good reports on the subject.

As a result of these kinds of efforts the Congress passed the Intergovernmental Cooperation Act of 1968. This act, Public Law 90-577, among other things:

1. requires that full and current information is to be furnished State executives and legislatures regarding the kind and amount of Federal grants-in-aid that have been awarded to and within their States,
2. removes the requirement currently in many separate grant statutes specifying a particular State agency to administer grant funds,
3. authorizes Federal departments and agencies to provide technical training and other services to State and local governments on a reimbursable basis,
4. authorizes the President to coordinate and ensure more effective utilization of Federal funds under all federally aided programs, and
5. makes provision for periodic review of Federal grant-in-aid programs that lack a specific termination date in order to ensure that these programs are kept in line with changing conditions and circumstances.

Proposed legislation termed the Intergovernmental Cooperation Act of 1970 would amend and extend the 1968 Act. The proposed legislation contains provisions for joint funding, grant consolidation, and improvements in accounting and auditing, and would require congressional committee oversight of specific grant programs.

There are other landmark enactments which have brought major improvements in administration of Federal grants-in-aid. One example, the Partnership for Health Act of 1966, currently urged as a model for

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"block grants," directs the consolidation of a dozen or more separate health program authorizations into a single authorization. Another example, the Demonstration Cities and Metropolitan Development Act of 1966, provides greater flexibility to local governments in using funds provided by the act for innovation or experimentation and for meeting immediate high priority needs of the particular locality.

It is also useful to note a few of the recent actions taken by the executive branch:

1. By Executive Order last February, President Nixon ordered the establishment of the Office of Intergovernmental Relations under the immediate supervision of the Vice President of the United States. This office, staffed by a director and a small number of professional personnel, serves primarily as a clearing house for the prompt handling of problems brought to the attention of the Office of the President, and for generally improving coordination between the Federal, State, and local governments.
2. In March 1969, the President ordered the establishment of uniform boundaries and locations of field offices for Federal agencies dealing with urban and economic problems to facilitate intergovernmental coordination at the regional level. Simultaneously, he directed the Federal agencies on the Urban Affairs Council and the Office of Management and Budget to work together to modernize the Federal system of assistance to States and localities.

3. The Office of Management and Budget issued several circulars to Federal agencies concerning portions of the Intergovernmental Cooperation Act of 1968 which provide for State and local clearinghouses for grant planning, which provide for services to be made available to State and local governments, and which describe the supplying of information to States on grant awards.
4. In August 1969, President Nixon proposed a work/welfare and Federal/State revenue sharing program which, if enacted, would undoubtedly result in greater attention to consolidation of grant programs and greater efforts to place more autonomy and discretion on State and local authorities determining program priorities and use of funds.
5. An Executive Order of April 1969 provides for experimentation with the joint funding of projects under the OEO and Juvenile Delinquency Acts and the designation of one Federal agency to administer grant funds.

Parallel with these efforts, a survey was initiated in 1968 under the auspices of the Federal Government's Joint Financial Management Improvement Program to study and identify more specifically the problems of financial administration of Federal grants-in-aid to State and local governments. This survey, carried out by an interagency study group under GAO leadership, resulted in a comprehensive report in September 1969 with numerous recommendations for follow-on study and action.

As many of you are aware, three interagency task forces have been formed to follow up on the President's directive of March 1969 to seek ways of modernizing grant-in-aid administration.

One of the task forces was organized under the Department of Health, Education and Welfare to investigate ways of improving the administration of grants to States. A second task force, under the Office of Management and Budget, had a similar objective with respect to grants to local governments. The two groups, now consolidated, have divided the subject into five areas: (1) grant applications and proposals, (2) reporting, (3) property management, (4) personnel management, and (5) general administration.

Each of these areas is important, but two of them deserve special mention.

Grant applications and budgeting

The first is the area of grant applications and proposals and the closely related matter of budgeting. Because of the complexity of the grant programs and, frequently because of the requirements of Federal program managers, the preparation of applications for grants by States and local governments has become an extremely difficult--some would say an impossible--process. The requirements for individual grant proposals are not only complex--there is little similarity between the requirements of one Federal department and those of other Federal departments having comparable programs. In many cases, there is inconsistency in the requirements within a single department.

The Advisory Council on Intergovernmental Relations attributed this dissimilarity to a "strong centrifugal force pulling against coordination within and among grant programs."

We recognize that there are conflicts that are detrimental not only to the well-being of the non-Federal community; they are also detrimental

the achievement of Federal objectives lying behind grant programs. It is the responsibility of the team presently working in this area to analyze the varying requirements of the Federal departments and agencies for grant applications and endeavor to resolve the conflicting specifications.

Adequate program and project budgeting is of course dependent on timely information as to the availability of Federal funds. In this connection, the National Governor's Conference in its recent meeting in Missouri made suggestions for:

1. Advance funding for at least two years to assure availability of funds, and
2. Annual appropriations prior to the start of the fiscal year to provide lead time for planning and personnel acquisition.

These suggestions, in the main, are a reiteration of recommendations made by the Advisory Council on Intergovernmental Relations in 1967, and certainly have very considerable merit. Our Office recommended advance funding in the strongest terms in testimony on the Intergovernmental Relations Act of 1970.

Accounting and Reporting

The need for improvement in the second area, i.e., accounting and reporting, has long been recognized. One of the most frequent criticisms is the lack of standardization among the Federal programs, which may require a single unit of government to use varying accounting structures and methods.

The reasons for the sometimes complex, oftentimes non-standardized accounting and reporting requirements are many. We are hopeful that through the efforts of the team working in this area improvements can be made.

An inventory of requirements placed on grantees, undertaken by the Department of Health, Education and Welfare, has provided a wealth of information in this area. The team is now examining and analyzing this data to get at the underlying reasons for the differences in accounting and reporting requirements. We anticipate that it will at least be able to make a beginning in establishing standards for accounting and reporting requirements and hopefully to lessen the burden placed on the grantee.

Auditing

The third task force, organized following the President's March, 1969, directive is engaged in developing a body of standards applicable to the auditing of Federally assisted programs.

During the hearings last year on the Intergovernmental Cooperation Act of 1970 we commented several times as to the need for the Federal Government to develop auditing standards that could be agreed upon as applicable to all Federal grant programs.

The committee chairman, Congressman L. H. Fountain of North Carolina, asked whether GAO could help to "upgrade the quality of postauditing in the States by setting standards that would enable Federal agencies to place greater reliance on State efforts."

Following the hearings, we suggested revised language for the pending Intergovernmental Cooperation Act to authorize the Office of Management

and Budget or such other agency as the President may designate, in cooperation with the Comptroller General, to develop and issue principles and standards of auditing for the guidance of Federal executive agencies, State and local governments, and independent public accountants engaged in the audit of Federal assistance programs.

This suggestion and others are still being considered by the Senate and House committees.

Not long after these hearings, with the cooperation of the Office of Management and Budget and other major Federal agencies directly involved in Federal grant programs, the GAO took the lead in organizing an interagency working group to spend full time reviewing grant program auditing problems and developing a body of auditing standards. This group began work in February 1970.

There are several interrelated purposes to be served by this effort. These purposes are to:

1. Promote improved auditing and thereby better management of the grant programs.
2. Obtain adequate evaluations pertaining to performance of programs and accountability for the public funds used in them.
3. Provide information resulting from such evaluations that will enable executive and program managers as well as legislators at State, local, and Federal levels to more effectively carry out their responsibilities.

4. Simplify auditing arrangements as much as possible.
5. Obtain agreement on auditing standards to be met as a basis for greater reliance by Federal agencies on the audit work performed by or for State and local governmental bodies.

In carrying out this project, we propose to suggest standards that should apply in the audit of Federal grant programs irrespective of who does the auditing or whether it is done by one group or by several groups. Bearing in mind that the audit of Federal grant programs also involves the audit of the performance of the Federal agencies who are responsible for administering Federal grants, the total auditing effort should be conceived as one to be carried out by more than one group.

In developing the standards, it is contemplated that the scope of auditing of the assistance programs will be complete and thereby embrace these broad areas:

- Fiscal and accounting operations, including controls over financial and property resources and financial reporting.
- Compliance with applicable Federal, State, and local governmental laws, regulations, and requirements.
- Identification of opportunities for greater efficiency and economy.
- Evaluation of effectiveness and accomplishments of the programs and expenditures.

The latter objective is the most evolutionary in the present state of development of the audit function, but it is also one of the most important. This objective seeks to answer the simple question of whether the programs as carried out and the expenditures as made are doing what they are supposed to do. We believe that this question is a

legitimate--perhaps the major--concern of the auditor; however, it will probably be challenged in many quarters.

There are many problems, concepts, and attitudes to be reconciled in constructing an integrated body of auditing standards. Yet the objective is sound since such an audit comes nearest to meeting the needs of program managers, agency heads, legislators, and the public.

One type of standard which can be expected to be suggested is that the extent of audit work to be performed in a given case should be determined on the basis of judgment as to the adequacy of the internal management control system in being, including the nature and quality of audit work that is being or may have already been performed. Application of this standard requires evaluation and testing as a basis for such judgment, but it is a commonly accepted and followed audit procedure.

The principle of audit reliance on established internal controls, including internal audit, is reflected in the general policy of the Federal Government, as expressed in Bureau of the Budget Circular No. A-73 in 1965, to make maximum use of audits performed by the internal or independent auditors of grantees and to avoid unnecessary duplication of audit work by Federal agencies.

Although this policy has been in stated form for over 5 years, it is difficult to assess its impact on actual practice. As the Joint Financial Management Improvement Program report of September 1969 pointed out, Federal agencies have made major gains in working with States and local governments to achieve greater reliance on and use of

non-Federal audits but far less than the maximum potential has been realized.

We are hopeful that we will be able to complete the project to develop an acceptable body of auditing standards within the next year. We are also exploring the possibility of developing and presenting a descriptive training course on their application as a Federal project without cost to our non-Federal partners, except for the cost of traveling to a convenient central location.

In closing, I want to commend you for your efforts in developing this first State-Federal financial management conference. We need more meetings of this nature, where we can listen to each other and try to understand each other's needs and problems. Effective communication can be a giant step in the resolution of financial management problems which have plagued all of us for many years. However, these matters can only be resolved by vigorous and effective participation on the part of the States and the Federal Government. Strong, organized action groups representing both parties can bring into being the necessary improvements in the management of these programs.

Let's hope that this is the first of many successful meetings. I can assure you of our sincere and vigorous cooperation.